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Managed Investment Pool (Including Endowments) Annual Report

University Of Maine System

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MANAGED INVESTMENT POOL (INCLUDING ENDOWMENTS)
YEAR ENDED JUNE 30, 2011

Additional copies are available at <http://www.maine.edu/system/oft/EndowmentFund.php> or by contacting:

The Office of Finance and Treasurer
16 Central Street
Bangor, ME 04401-5106

Managed Investment Pool (Including Endowments) – Annual Report

University of Maine System Year Ended June 30, 2011

The University of Maine System (UMS) Managed Investment Pool (Including Endowments), hereinafter called the MIP, includes UMS endowment funds and funds from the following other entities:

- UMS Other Post Employment Benefits (OPEB) Trust
- University of Maine at Farmington Alumni Foundation
- University of Maine at Fort Kent Foundation
- University of Southern Maine Foundation
- John L. Martin Scholarship Fund, Inc.
- Maine Maritime Academy

UMS endowment funds are subject to the restrictions of gift instruments. The principal is invested and current expenditures are funded from related income and appreciation.

Oversight and Management

Portfolio and investment management is an ongoing process with the following parties meeting routinely to provide oversight of MIP assets:

- Board of Trustees Investment Committee
- Investment Consultant – New England Pension Consultants (NEPC) – Cambridge, MA
- Rebecca Wyke, Vice Chancellor for Finance and Administration and Treasurer, UMS
- Tracy Elliott, Director of Finance and Controller, UMS

Governing Guidelines

Formal guidelines, established by the Investment Committee, govern the MIP investment process.

These guidelines, last updated in August 1, 2011, may be found at

<http://www.maine.edu/system/oft/InvestmentGuidelines.php>. They include:

- Total risk and return objectives
- Third party investor criteria
- Statement of goals and objectives
- Investment guidelines including:
 - Asset allocation with target percentages, permissible ranges, and evaluation benchmarks, and
 - Permitted and excluded investments
- Investment manager performance standards and evaluation
- Responsibilities of all parties
- Conflict of interest statement

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These guidelines currently target a long-term return objective for the MIP of 8.25% with moderate risk. This rate expectation is down from prior year's 8.5% as a result of a lower market return environment. Factors informing this view include bond yields that are the lowest in 50 years, stock fundamentals that do not appear likely to support high risk premiums over bonds, and muted economic growth expectations due to unemployment and governmental debt overhang concerns.

Fiscal Year 2011 Performance

The market continued to appreciate during fiscal year 2011 (FY11) allowing the MIP to far exceed its goals and objectives. Nonetheless, the economic recovery going forward remains weak with continued high unemployment, high governmental debt levels, general market uncertainty and volatility, and a recovery largely based on governmental actions. As a result, forward-looking expected returns have declined.

The MIP **experienced a return of 22.3%** [21.9% net of fees] in FY11. The MIP's performance placed it in the 22nd percentile (i.e., exceeding 78%) of the total endowment fund universe tracked by the UMS's investment consultant. The UMS return of 22.3% compares to the S&P 500 return of 30.7% and the Barclays Capital Aggregate Bond Index return of 3.9% over the same 1 year period.

The MIP's **5-year annualized return of 5.9%** [5.5% net of fees] ranks the fund in the 22nd percentile, meaning the fund performed better than 78% of other endowment funds in the universe while the risk taken (at the 65th percentile) as measured by the standard deviation was also greater during the same period. However, the risk adjusted return or Sharpe Ratio placed in the 33rd percentile, meaning that the MIP was compensated for the amount of risk taken. This return compares to the S&P 500 return of 2.9% and the Barclays Capital Aggregate Bond Index return of 6.5% over the same 5 year period.

On June 30, 2011, the MIP assets totaled \$192.7 million, increasing \$43.8 million over the prior year end balance as detailed below under the section called "MIP Inflows and Outflows".

Changes in Investment Managers

Hedge Fund Manager

At its June 1, 2010 meeting, the Investment Committee agreed to restructure the hedge fund category, terminating Fidelity Market Neutral and conducting a search for a new manager. The Investment Committee interviewed firms in December 2010 and engaged Blenheim Global Markets Fund Ltd. to manage a 3% target allocation in the MIP.

Small Cap Manager

NEPC recommended a client review of Mesirow, a small cap equity manager in the MIP, due to personnel changes. A manager search was subsequently conducted, managers were interviewed, and at the September 30, 2010 meeting, Dimensional Fund Advisors (DFA) was engaged to replace Mesirow as the Small Cap Manager.

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MIP Inflows and Outflows

The following information is provided for FY10 and FY11 and includes all MIP assets (i.e., assets of the UMS and amounts held for others) as well as related UMS cash on hand temporarily invested in the operating fund, accrued fees, and a small amount of separately invested funds.

	(\$ in Thousands)	
	<u>FY10</u>	<u>FY11</u>
Beginning Market Value – July 1	<u>\$127,039</u>	<u>\$148,899</u>
Gifts (UMS and UMS affiliated organizations)	\$3,347	\$3,002
Other Post Employment Benefits Trust Contributions	9,034	13,588
Maine Maritime Academy Contributions net of Withdrawals	(264)	(239)
Interest and Dividend Income	2,985	2,953
Net Appreciation (Depreciation)	12,481	30,462
Fees/Expenses (Net of Rebate)	(1,192)	(1,601)
Distribution for Scholarships & Operations	(4,600)	(4,840)
Charitable Gift Annuities (Net of Annuitant Payments)	(31)	(56)
Return to Principal upon Donor Request	83	202
Miscellaneous Transfers	17	303
Net Activity for the Fiscal Year	<u>\$21,860</u>	<u>\$43,774</u>
Ending Market Value – June 30	<u>\$148,899</u>	<u>\$192,673</u>

The following is a summary of the market value of the entities invested in the MIP at June 30, 2010 and 2011:

Summary of Market Value by Entity	(\$ in Thousands)	
	<u>June 30, 2010</u>	<u>June 30, 2011</u>
University of Maine System and Affiliates	\$104,393	\$124,999
Other Post Employment Benefits	29,940	50,170
Maine Maritime Academy	14,566	17,504
Total	<u>\$148,899</u>	<u>\$192,673</u>

Returns, Historical Growth, and Allocation

Attachment I reports the total returns for the MIP on a net of fees basis and the MIP's year end market value for the past 5 years, as well as the asset allocation for the fiscal years ended June 30, 2010 and 2011.

MIP funds are well diversified by style, asset class, and geography across 15 different investment managers. The large size of the MIP permits fuller diversification (which enhances risk adjusted returns) as well as access to attractive asset classes and managers. Additionally, pooling of funds allows participants to benefit from reduced investment manager, consultant and custodial fees.

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Endowment Distribution

The UMS endowment distribution formula is designed to smooth market volatility. The method uses a 3-year market value average with a percentage spending rate applied. The rate applied for FY11 was 5% and is 4.75% for FY12. Reducing the rate by .25% brings UMS more in line with other educational endowments, enabling better preservation of corpus.

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University of Maine System

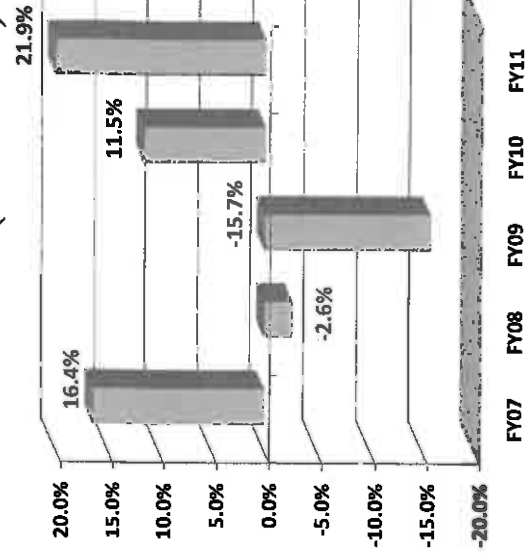
Market Values, Asset Allocations, and Total Returns
June 30, 2011

Market Value and Asset Allocation of the MIP (\$ in Thousands)

	June 30, 2010		June 30, 2011	
	Market Value	% Allocation	Market Value	% Allocation
Domestic Equities	\$53,763	36%	\$55,427	29%
International Equities	22,290	15%	38,582	20%
Multi Strategy Bond	20,339	14%	27,975	15%
Market Neutral	4,159	3%	-	0%
Global Asset Allocation	21,769	14%	30,636	16%
Hedge Funds	14,691	10%	31,373	16%
Timber Fund	4,159	3%	4,212	2%
Cash	7,729	5%	4,468	2%
Total	\$148,899	100%	\$192,673	100%

Total returns (net of fees) and the market value of MIP assets for the five years ended June 30, 2011 are shown in the charts below. The large cash balances (above) include OPEB contributions held by the MIP's custodian (The Bank of New York Mellon) for July investment totalling \$6 million and \$3 million for the years ended June 30, 2010 and 2011, respectively.

Total Return (Net of Fees)



Market Value (\$ in Millions)

